regulation will not cause competitive harm.[42] The Commission seeks comment on these tentative conclusions in the context of its specific reform proposals.

As shown in the following sections, most of the changes proposed by the Commission would give the LECs an unprecedented degree of pricing flexibility. They would not serve the Commission's general objectives as stated in earlier phases in the LEC price cap proceedings nor the specific objectives identified in the SFNPRM.

As the Commission has properly concluded, because the LECs "retain substantial market power in providing local exchange and access services, regulation continues to be needed to achieve the goals of the Communications Act, and to increase consumer welfare."[43] The original goals of the price cap plan -- "just, reasonable, and nondiscriminatory rates, as well as a communications system that offers

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[42] SFNPRM, ¶ 29. The Commission defines "competitive harm" in "terms of the ability of a LEC to prevent prices paid by access customers from moving toward their efficient economic cost or to reduce the quality or range of services provided to access customers or to impose unreasonable endogenous barriers to entry." Id., ¶ 28. It also includes "LEC actions that could affect adversely competition in the interexchange market." Id. Most fundamentally, "competitive harm" thus includes the LECs' ability to engage in monopoly pricing, cross-subsidization, predatory pricing, and unreasonably discriminatory pricing. Id., ¶ 19.

[43] First Report, ¶ 92.

innovative, high quality services"[44] -- should continue to guide the Commission. Price cap regulation has been successful in incrementally reducing rates for consumers without protracted regulatory proceedings, while simultaneously providing the LECs increased incentives to become more efficient, productive and innovative.

Thus, until objective criteria demonstrating the existence of actual and meaningful local exchange and access competition can be satisfied, the Commission should maintain detailed price cap controls and procedures to ensure the reasonableness of interstate access rates and to achieve the Commission's stated objectives. The Commission must not lose sight of its statutory imperative that "in considering possible revisions to the LEC price cap plan, our primary goal will be to maximize the benefits of the plan to consumers and society, in accordance with the purposes and requirements of the Communications Act."[45]

For the most part, the Commission's proposed price cap reforms would not further the public interest and should not be adopted at this time. First, certain of the

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[44] See Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786, 6787 (1990) ("LEC Price Cap Order"), recon. 6 FCC Rcd. 2637 (1991)("LEC Price Cap Reconsideration Order"), further recon. 6 FCC Rcd. 4524 (1991), second further recon. 7 FCC Rcd. 5235 (1992), aff'd sub nom. National Rural Telecommunications Association v. FCC, 988 F.2d 174 (D.C. Cir. 1993).

[45] First Report, ¶ 93.

substantive modifications would afford the LECs undue flexibility that could result in increased rates and discriminatory strategic pricing. Second, the suggested procedural changes would not allow for sufficient review of LEC pricing for their access services, and would allow de facto broadscale revisions of the Part 69 Access Charge Rules without the safeguards attendant to a rulemaking or the usual waiver process. Nonetheless, with certain modifications and safeguards, some of the proposed reforms to the price cap plan could be adopted now to enable access prices to move closer to costs, without these untoward effects.

A. The Current Cost Support And Notice Requirements For New Services And Restructures Should Be Retained.

The Commission proposes to substantially relax the regulatory treatment of new services by creating two categories of new services. Track 1 services would be subject to the current 45-day notice and detailed cost support requirements.[46] For Track 2 services, however, the

[46] SFNPRM, ¶ 45. The current rules require a LEC to identify the direct costs of a new service which must be based on a consistent costing methodology for all related services. The methodology for assigning overhead costs, if any, to the new service must be justified, although overhead loadings need not be uniform. Prices must exceed direct costs, ensuring that they are not predatory. Also, according to the Commission, the rules regarding overhead costs establish a "flexible cost-based upper bound" on the pricing of new or substitute services. Id., ¶ 41 (citations omitted).

notice requirement would be reduced to 14 days and the LEC would only have to show whether the service recovered all of its direct costs.[47]

There is no basis for relaxing the price cap treatment for any new services. The current cost showing, which includes a requirement that the LEC justify its overhead allocations, is an important factor in determining whether a LEC is pricing its service reasonably. By contrast, and at best, a direct cost showing could only demonstrate that a LEC is not pricing a new service predatorily; it does not guard against a LEC pricing a monopoly service too high.

The ability of interexchange carriers ("IXCs") to meet the evolving market-driven needs of their customers is vitally dependent on their ability to obtain new access services at reasonable, nondiscriminatory rates. Relaxation of cost support requirements for new services would frustrate this objective. No access customer has urged the Commission to relax the cost support required for introduction of new services. Indeed, as USTA admitted last year, the LECs have introduced approximately 440 new services in the little over three years that price caps had

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[47] <u>SFNPRM</u>, ¶ 49.

then been in effect.[48] Given these facts, the Commission has not tentatively concluded -- nor could it ultimately conclude -- that the current test imposes undue administrative burdens on the filing carrier, or that modification of the test would in any way further consumer interests. To the contrary, there is every reason to expect that it would not.[49]

Not only would the reduction of the cost support requirements allow the LECs to price their new services unreasonably, but the 14-day notice period would not afford sufficient time for meaningful objection and Commission review.[50] Indeed, the 14-day notice period was crafted for filings deemed presumptively lawful,[51] which "new services"

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48 See AT&T Reply Comments, CC Docket No. 94-1, June 29, 1994, p. 39, citing USTA Comments, id., May 9, 1994, p. 18.

49 There is little question that the LECs would exploit any flexibility afforded to them to disadvantage their access customers and price their service at whatever monopolistic level or discriminatory manner that the market would bear. See, e.g., U S WEST Communications, Transmittal No. 487, Order, DA 94-1333, released November 29, 1994 (rejecting a proposed term and volume plan with geographic restrictions as unreasonably discriminatory); see also Local Exchange Carrier Line Information Database, 8 FCC Rcd. 7130, 7132, 7144 (1993) (finding that LEC LIDB rates based "on what the market would bear" to be unlawful).

50 The Commission's rules only allow 6 days for filing of a petition to reject or suspend a tariff filed on 14 days' notice. See 47 C.F.R. § 1.773(a)(2)(i) (1994).

51 See 47 C.F.R. § 61.58(c)(2) (1994) (14 days' notice for below cap, within band filings that change a rate level,

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are not.[52] Given the captive customer base for access services and the fact that, as a general proposition, a shorter period is not needed to allow more rapid introduction of new offerings, the notice period should not be reduced.[53] To the extent that the introduction of new services (such as access for 500 and advanced intelligent network services) has been delayed, the LECs themselves, not

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add a geographic location, eliminate a rate element, etc.).

[52] The Commission just recently reaffirmed the need for a 45-day notice period for the LECs' new video dialtone services to allow time for adequate review. Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, CC Docket No. 94-1, Second Report and Order and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd. 11098, 11103 (¶ 28) (1995).

[53] In the unlikely circumstance that access customers' service needs could not be timely met, a LEC could, of course, seek to expedite the effective date of a pending new service tariff if there is no intervention. If the Commission nonetheless decides to reduce the notice period, it should require tariffs introducing new services to be filed on at least 30 days' notice. This would afford potential intervenors 15 days to file their petitions and allow for timely Commission review. See 47 C.F.R. § 1.773(a)(2)(iii) (1994). If the Commission adopts procedures to allow a LEC to request Track 2 treatment of a new service, it should ensure that interested parties have an adequate opportunity to review and comment on the LEC's request regardless of how it is presented (e.g., as a request for waiver of the Part 61 rules or for declaratory ruling). In no event should Track 2 treatment be based solely on a LEC certification letter or be allowed because the Bureau fails to act within a specified timeframe. SFNPRM, ¶ 48.

the regulatory process, have been a major cause of the delay.

Although the Commission proposes to maintain the existing price cap support requirements for restructures (i.e., showing of PCI, API, SBI), it similarly proposes to reduce the 45-day notice requirement.[54] The SFNPRM suggests, for example, that restructures that increase rates could be filed on 15 days' notice, and restructures which reduce rates could be filed on even shorter, i.e., 7 days' notice.[55] There is no reason to reduce the notice period for restructures. Restructured services supersede the existing variant of an offering and thus, like new services, demand careful review. Moreover, if a shorter notice were allowed for restructures that reduce rates, it would be all too easy for the LEC to "game the process" by introducing a restructure on short notice and later raising the price.

B. Alternative Pricing Plans Should Be Treated As New Services.

The Commission proposes to revise the definition of "new services" to exclude Alternative Pricing Plans ("APPs") that offer discounted optional rates for a service

[54] Under price caps, a "restructured service" replaces an existing service and thus does not expand the range of services available. SFNPRM, ¶ 20.

[55] SFNPRM, ¶ 51.

that continues to be offered.[56] Under the Commission's proposal, an APP would be distinct from either a new service or a restructure, and could, for example, be introduced on 14 days' notice and without cost support for 90 days. After that time, APPs could be converted to new services, on 45 days' notice and with cost support under Section 61.49 The Commission also asks whether it should allow LECs to offer APPs other than those term and volume discounts which are currently allowed, "so long as the LEC continues to offer the standard service offering of which the APP is an optional discount plan."[57]

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[56] SFNPRM, ¶ 52. Under price caps, "new services are . . . defined as services that add to the range of options already available to customers." Id., ¶ 40. Thus, under current rules, an APP is a new service, even though it is "functionally indistinguishable from an existing service" simply because it is offered under different rates, terms and conditions. Id.

[57] SFNPRM, ¶ 59. The Commission has allowed the LECs to implement term and volume plans for special access, and also for switched transport (entrance facilities, direct-trunked transport, and tandem-switched transport) once expanded interconnection becomes operational and collocation reaches a sufficient level to "demonstrate[] that the LECs' expanded interconnection tariffs provide a viable competitive opportunity." See Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Transport Phase I, Second Report and Order and Third Notice of Proposed Rulemaking, 8 FCC Rcd. 7374, 7423-24 (¶ 93) (1993) ("Switched Access Interconnection Order"); Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd. 7369, 7491 (¶ 262) (1992) ("Special Access Interconnection Order").

The Commission should continue to review APPs under the "new services" test. The key issue with any APP is whether it is unreasonably or unjustly discriminatory. Cost support is essential to determine whether the LEC is recovering its costs via an APP or will be burdening other customers. If the Commission allowed LECs the flexibility to offer APPs -- for any period of time -- without an opportunity for thorough review of their potential for discrimination, it would be abandoning its duty to ensure that rates are not unlawfully discriminatory. Discrimination is a real concern in the LEC environment, where competition is extremely limited.[58]

A number of the LECs have sought to introduce non-cost-based percentage or growth discount plans, which would have provided customers with high growth rates a substantially lower effective per-minute rate for switched access than customers with the same amount (and sometimes higher levels) of traffic but with lower growth rates.[59]

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[58] By contrast, the Commission's concerns as to the discriminatory impact of AT&T's optional calling plans and promotions were misplaced because of fierce competition in the interexchange market. See Revisions to Price Cap Rules for AT&T, CC Docket No. 93-197, Further Notice of Proposed Rulemaking, 10 FCC Rcd. 7854 (1995); see id., AT&T Comments, filed July 3, 1995, pp. 16, 21; AT&T Reply Comments, filed July 24, 1995.

[59] See, e.g., AT&T Comments on NYNEX Telephone Companies Petition for Waiver of Part 69 of the Commission's Rules to Offer the Vermont Market Plan, DA 93-1005, filed September 8, 1993, pp. 3-4; NYNEX Motion to Withdraw Waiver Petition, filed September 30, 1994. See also AT&T

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Such plans clearly distort competition in the interexchange market. To guard against this discriminatory potential -- which would only be exacerbated to the extent the LECs also offer interexchange services -- the Commission should retain the cost showing requirements of the current new service test for APPs.

In addition, the Commission should not allow term and volume pricing plans for switched access other than those already permitted for various local transport elements (see n.57, supra). First, term and volume plans should not be permitted for rate elements which constitute non-cost-based subsidies for the LECs' local services, such as the residual interconnection charge ("RIC") and carrier common line charge ("CCLC"). Any discount for such elements would necessarily be non-cost-based and would simply allow the LEC to discriminate among access customers as to who should bear the greatest subsidy burden. Second, because of the absence

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Comments on GTE Telephone Operating Companies Petition for Waiver of Part 69 of the Commission's Rules to Offer a Switched Access Discount Plan, filed September 3, 1993; AT&T Petition to Reject or, in the Alternative, to Suspend and Investigate NYNEX Telephone Companies Revisions to Tariff F.C.C. No. 1, Transmittal No. 311, filed July 25, 1994, pp. 6-8; AT&T Petition to Reject or, in the Alternative, to Suspend and Investigate, Cincinnati Bell Telephone Company Revisions to Tariff F.C.C. No. 35, Transmittal No. 658, filed July 27, 1994, pp. 5-6; AT&T Comments on Pacific Bell Petition for Waiver of Part 69 of the Commission's Rules to Offer Optional Pricing Plans, filed January 21, 1994, pp. 5-7.

of competition for local switching and other services in the traffic sensitive basket, there is no need for the Commission to authorize term and volume discounts for these elements to enable the LECs to compete effectively.

Moreover, because the LECs can deploy switching in increments, the costs of switching generally do not vary with volume in the same way as the costs of transport, and therefore (unlike for transport), any economies of scale for switching are likely to be minimal or nonexistent.[60] If the Commission nonetheless allows term and volume plans for local switching (either by a rule change or pursuant to waivers) -- which it should not -- it should ensure that such discounts reflect only the actual cost differential between the discounted and non-discounted offerings.[61]

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60 See, e.g., NYNEX Telephone Companies Petition for Waiver - Transition Plan to Preserve Universal Service in a Competitive Environment, 10 FCC Rcd. 7445, 7469 (¶ 56 and n.103) (1995) ("NYNEX USPP Order") (Commission "emphasize[d]" that, although it granted NYNEX some measure of deaveraging based on the unique circumstances in the New York City LATA, it has not "reach[ed] a conclusive finding" that non-transport costs vary with density of traffic.)

61 In no event should the Commission allow discounts for the tandem switching charge which, under the interim transport rate structure, is already heavily subsidized via the RIC. See Transport Rate Structure and Pricing, 7 FCC Rcd. 7006 (¶¶ 23-25, 29) (1992), recon., 8 FCC Rcd. 5370 (1993), further recon., 8 FCC Rcd. 6233 (1993), further recon., 10 FCC Rcd. 3030 (1994), appeal pending, sub nom. Competitive Telecommunications Association v. FCC, No. 95-1168 (and consolidated Case No. 95-1170) (D.C. Cir.)

C. The Proposals For Individual Case Basis Tariffs Should Be Adopted To Codify Existing Policy.

AT&T supports the Commission's proposals on individual case basis ("ICB") offerings (i.e., "the practice of developing a price for a particular service or facility in response to each customer request for the service or facility"[62]), which appear to specifically incorporate existing policy, as recently restated by the Common Carrier Bureau.[63] In the SFNPRM, the Commission proposes "requiring a LEC seeking to offer a common carrier service, except for special construction, at ICB rates to show in the supporting documentation that the service is so unlike any existing service that the LEC would have no reasonable basis to develop generally available rates."[64] Section 61.38 support requirements would apply to ICB tariffs, and they would continue to be excluded from price cap regulation. After an ICB tariff is offered to more than two customers or for more

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[62] SFNPRM, ¶ 62, citing Local Exchange Carriers' Individual Case Basis DS3 Service Offerings, 4 FCC Rcd. 8634, 8641, (¶ 63) (1989). Such pricing is usually reserved for services that the carrier "has no experience in providing" or for special construction. Id. ICB services are excluded from price cap regulation because they are contract-type services that are not generally available. SFNPRM, ¶ 63, citing LEC Price Cap Order, 5 FCC Rcd. at 6810 (¶ 193).

[63] See "Common Carrier Bureau Restates Commission Policy on Individual Case Basis Tariff Offerings," Public Notice, DA 95-2053, September 27, 1995 (citations omitted).

[64] SFNPRM, ¶ 65.

than six months, it must be treated as a new service, subject to the new service requirements.[65]

The SFNPRM proposal properly recognizes that instances of ICB pricing, particularly in noncompetitive markets, should be strictly limited. It affords LECs the flexibility to respond to unique customer needs that, at least initially, cannot be based on averaged rates, but recognizes the anticompetitive potential of ICB pricing. To preclude abuses, the proposed test should be strictly enforced, and in no instance should a LEC be permitted to employ ICB pricing for itself or an affiliated entity. Moreover, an offering should not be deemed "unlike an existing service" if it is available through the LEC's end user tariffs[66] or is an inherent part of the LEC network, whether or not it was previously offered to customers.[67]

D. The Part 69 Waiver Process Should Not Be Revised.

The Commission's Part 69 rules prescribe the current switched access elements and underlying rate

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65 Id.

66 United States v. Western Electric Co., Civil Action No. 82-0192, Memorandum Opinion (D.D.C. Nov. 26, 1986), aff'd, No. 87-5110 (D.C. Cir. May 10, 1988) (finding U S WEST violated the nondiscrimination provisions of the Modification of Final Judgment by pricing special access to GSA at a rate lower than that available to IXCs).

67 For example, DS3 trunks were used by the LECs within their own networks prior to being offered to customers under ICB arrangements.

structures. The Commission proposes to change the waiver procedures a LEC must follow to establish a new switched service rate element under Part 69.[68] Specifically, the Commission suggests that a waiver would be granted if the proposed offering "would serve the public interest."[69] Thereafter, copycat rate structures for other LECs would be permitted upon submission of a certification letter stating that the LEC intends to provide the same service with the same elements.[70] Subsequent LECs' waiver requests would be deemed granted within 10 days, unless the Bureau concludes that a copycat offering raises issues not considered in the original waiver. In that case, the Bureau would deny the certification, and the LEC would have to file its own waiver request.

These proposals should not be adopted. In the LEC Price Cap Order, the Commission expressly required the LECs to continue to adhere to the Part 69 rules for the switched access rate elements, because the rate structures embodied

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[68] SFNPRM, ¶ 67.

[69] Id., ¶ 71. The SFNPRM (¶ 72) suggests that the first LEC filing for a waiver could describe the service and possible alternative rate elements, from which the Bureau could choose. Part 69 rate element waivers and a request for Track 2 treatment of the new service could be combined in a single expedited petition.

[70] Id. The certification letter would be required to include a service description and rate elements to allow analysis.

in those rules are designed to eliminate unreasonable discrimination between service users. As the Commission correctly found, in the face of the LECs' significant market power in the provision of interstate access, rules that discourage unreasonable discrimination and its potentially adverse impact on competition should be given precedence over the benefits that might come from LECs' ability to depart from the Part 69 access rate structure.[71] This continues to be the case. Indeed, the Commission only recently concluded that the "record in this proceeding does not support a finding that competition for LEC services is sufficiently widespread to constrain the pricing practices of LECs for new services. Accordingly, the Commission will continue to review new services tariff filings for possible discrimination."[72]

The proposed changes to the Part 69 waiver process would not further the Commission's objective (and obligation) to limit unreasonable discrimination. First, the proposed waiver standard is too lenient, because it runs afoul of the Court of Appeals' admonition that the Commission may not "tolerate evisceration of a rule by

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[71] LEC Price Cap Order, 5 FCC Rcd. at 6826 (¶ 325).

[72] First Report, ¶ 416.

waivers."[73] Currently a party seeking a waiver must show "good cause therefor," which the courts have interpreted to require a showing that "special circumstances warrant a deviation from the general rule and such deviation will serve the public interest."[74] The Common Carrier Bureau has explained that, before it can grant a Part 69 waiver request, it must find that an applicant has "shown such special circumstances as individualized hardship or inequity that warrant deviation from the Commission's . . . rules and [that] such deviation better serves the public interest."[75]

This test appropriately recognizes that the Part 69 rules themselves further an important objective: nondiscriminatory rate structures. Eliminating the required showing of individual hardship/inequity will almost render the Part 69 rules obsolete, as they apply to the introduction of new service elements. The current waiver test allows LECs to obtain a Part 69 waiver only in limited circumstances. The Commission's proposal would free the LECs from almost any restraints to deviate from the Part 69 rules.

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[73] WAIT Radio v. FCC, 418 F.2d 1153, 1159 (D.C. Cir. 1969), cert. denied, 409 U.S. 1027 (1972).

[74] Northeast Cellular Telephone Co. v. FCC, 897 F.2d 1164 (D.C. Cir. 1990); WAIT Radio v. FCC, supra.

[75] Petition for Waiver of Transport Rate Structure and Pricing Requirements, 9 FCC Rcd. 796, 800 (1994).

Just as important, the proposed waiver procedures do not make sense. According to the Commission, "the first LEC proposing the new switched access service [would be permitted] to provide less specificity in the description of its proposed rate structure than we have required previously."[76] Based on the LEC's service description and various alternative rate element proposals, the Bureau could choose acceptable rate elements. However, in the absence of specific information on the proposal, neither the Bureau nor interested parties could properly evaluate the potentially discriminatory impacts of the proposed rate structure.

Moreover, once an initial waiver request is approved, other LECs would then be permitted to copycat the rate structure. This "copycat" procedure erroneously assumes that the circumstances which justify granting a Part 69 waiver request for one LEC would be equally applicable to all LECs.[77] Under the Commission's proposal,

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[76] SNFPRM, ¶ 72.

[77] In recent Part 69 waiver requests, the Commission has generally relied heavily on the specific competitive circumstances of the individual LEC to evaluate whether special circumstances warrant such a waiver. For example, in the NYNEX USPP Order (¶¶ 38, 39, 46), the Commission accepted the NYNEX premise that "competitive developments" in the NYNEX market constitute "special circumstances." Under the Commission's proposal, a NYNEX-like petition would no longer be evaluated to test if "competitive circumstances" have created any "special circumstances" to justify a waiver. Moreover, all other LECs would automatically get the same waiver without any

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not only would the first LEC be allowed to establish new Part 69 rate elements with minimal scrutiny, but once it obtains permission to establish certain new rate elements, all other LECs would almost automatically get permission to follow suit.

Thus, for all practical purposes, LECs would be able to obtain broadscale de facto rule changes with minimal Commission scrutiny, and interested parties would only have the opportunity to evaluate the Part 69 waiver request of the first LEC petitioner. Knowing that approval of the first waiver request will mean almost automatic approval of copycat requests, interested parties would be forced to treat the first waiver request as a rulemaking, and to evaluate the waiver request as if it were applicable to all other LECs. In short, the revised waiver procedures would replace the current rulemaking process, without the usual notice and comment timeframes, and without the careful scrutiny and deliberation, typically associated with rulemaking proceedings.

In view of the LECs' significant market power, each LEC must be required to show that its own special circumstances warrant a deviation from Part 69 rules in establishing new switched access rate elements, and that

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consideration of the conditions in their individual markets.

such deviation is in the public interest. Simplified Part 69 waiver processes should not be a substitute for rulemaking. Moreover, instead of deflecting its resources by acting on piecemeal and potentially anticompetitive waiver requests under a relaxed standard, the Commission should implement fundamental (and much-needed) access reform by promptly conducting rulemakings that address the anticompetitive and uneconomic impacts of the subsidies that currently inhere in the access and separations rules.[78]

E. Lower Service Band Index Limits Should Be Eliminated, Provided Safeguards Against Cross-Subsidization and Predatory Pricing Are Imposed.

The Commission proposes eliminating the lower service band indices ("SBIs") for each of the service categories and subcategories within the traffic sensitive and trunking baskets.[79] According to the Commission,

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[78] The Commission has recognized that this system of subsidies was created in a monopoly environment and itself acts as a barrier to local exchange competition. NYNEX USPP Order, ¶¶ 26, 29, 44; SFNPRM, ¶¶ 24-26.

[79] SFNPRM, ¶ 83. The current SBI limits for service bands in the traffic sensitive and trunking baskets are set at five percent above and ten percent below the aggregate price of each service band and sub-band at the beginning of each rate period. The lower SBI limits for the zone density sub-bands are set at fifteen percent. These upper and lower SBI limits then become a "no suspend" zone within which the LECs may move their prices, as adjusted for changes in the baskets' price cap indices ("PCIs"), with a presumption of lawfulness. By contrast, price changes that lower the aggregate price in a service band or sub-band below the lower SBI limit must be filed on 45 days' notice and must be accompanied by supporting materials establishing that the rates cover the service

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eliminating the lower SBIs "would increase LEC pricing flexibility and allow price cap LECs to move prices closer to cost."[80] At the same time, the Commission notes that the tariff intervention and Section 208 complaint processes would remain available to address predatory pricing, although the upper SBI limit and the price cap "would remain as disincentives to predatory pricing."[81]

AT&T supports the Commission's proposal to eliminate lower SBI limits to help move access prices to their economic costs. However, because eliminating lower SBI limits could result in cross-subsidization and predatory pricing, sufficient safeguards must be put in place to protect the LECs' customers and potential competitors against these practices, and to ensure that this additional pricing flexibility will, in fact, help achieve cost-based pricing.

The Commission has repeatedly noted that the current upper and lower SBI limits serve two key purposes.

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band's average variable cost. See 47 C.F.R. § 61.49(d) (1994). See also Section 61.47 of the Commission's Rules, as amended by the First Report. Eliminating the lower band limit would allow LECs to file rate decreases (below the preexisting limit) with a presumption of lawfulness, on short notice and without cost support.

[80] SFNPRM, ¶ 83.

[81] Id.

First, they restrict LECs' ability to engage in cross-subsidization among different service categories by decreasing the prices in one band and increasing the prices in some other band.[82] Second, the lower band limits serve as disincentives for LECs to engage in predatory pricing.[83] Without appropriate safeguards, elimination of lower SBI limits will substantially enhance LECs' ability to cross-subsidize among service categories.

The current price cap system allows the LECs to compensate for price decreases in one service band by increasing the prices of any other service band in the same price cap basket. By eliminating the lower SBI limits, LECs' flexibility to compensate for the rate decreases by

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82 SFNPRM, ¶ 80. (". . . the services category bands constrained the LECs' ability to offset rate reductions in some service categories with rate increases in other categories.") See also LEC Price Cap Order, 5 FCC Rcd. at 6810-11 (¶ 198).

83 SFNPRM, ¶ 105. ("The lower service band limits were designed to prevent LECs from lowering their prices below cost in order to thwart competition and then raising them after competitors have been driven from the market." SFNPRM, ¶ 83). Thus, the current +5% and -10% service band limits, relative to changes in basket PCIs, assure that during any rate year, LECs will not be able to increase the prices of any service band by more than 5%, to compensate for price decreases in any other service band. Similarly, the lower service band limits of -10% for the service bands and sub-bands, and -15% for the zone density sub-bands, serve as a check on LECs' ability to decrease the prices for the sole purpose of discouraging competitive entry in their markets. See LEC Price Cap Order, 5 FCC Rcd. at 6814 (¶ 226); see also First Report, ¶¶ 26, 29, 384, 409-11; SFNPRM, ¶ 77.

raising the rates in other bands will substantially increase.[84] Thus, LECs will be able to impose additional rate increases on their captive customers, while providing rate relief to their more competitive services. More importantly, there would be no aggregate decrease in LEC access prices, because the LECs would be able to fully recover the price reductions of one service band from price increases in other service bands.

The sole legitimate purpose for granting LECs additional downward pricing flexibility is to permit them to move their service prices to their economic costs more quickly. Therefore, the Commission should, as a condition of eliminating lower SBI limits, require the LECs not to compensate for their below-band price reductions with price increases in the other service bands.[85] This can be

[84] Appendix B demonstrates that removal of lower SBI limits will substantially increase a LEC's ability to cross-subsidize among service bands. In the example displayed in Appendix B, Example 1, under the current rules, a LEC with two service bands in a price cap basket, where Band A is priced at $1000, and Band B is priced at $4000, will be able to move only $271 from Band A to Band B over a three-year period. Once the lower SBI limits are removed, Appendix B, Example 2, shows that the same LEC would be able to move $631 from Band A to Band B over the same period. This is a 233 percent increase in the LEC's ability to cross-subsidize among the service bands. Appendix B, Example 3, further demonstrates that placing a one percent upper limit on price increases, after the prices are decreased below the lower SBI limits, will still provide the LEC with the same 233 percent increase in its ability to cross-subsidize among service bands.

[85] An extreme measure would be to place the service bands in which LECs implement below-band pricing in a separate

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accomplished by requiring the LECs to exclude any price reductions beyond the existing lower limits from the basket Actual Price Index ("API") calculation. This will enable the LECs to compensate for price reductions only up to the preexisting lower SBI limits of a band, but will ensure they cannot compensate for price decreases that are below the current SBI lower limits.[86]

In addition, the Commission should adopt its proposal to reduce the upper SBI limit from five percent to one percent for any service category or subcategory in which a LEC makes price reductions below the former SBI limit.[87] In combination with the above safeguard to deter cross-subsidization among service bands, this limit will further the Commission's policy goals of moving LEC prices toward

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price cap basket, in addition to subjecting these bands to a one percent upper SBI limit.

[86] The Commission could implement this condition by requiring the LECs to report two sets of prices for bands when they implement pricing below the former band limits. One set of prices would be those that would have resulted if, at the time below-band prices were first implemented, the LEC had priced the band at its existing lower SBI limit. This set of prices would change only with subsequent changes in the basket PCI and would be used for any subsequent API calculations. LECs should also report their actual prices. As long as the SBI that is calculated for actual prices is below the SBI calculated for the other set of prices, the actual rates should be excluded from the API calculation.

[87] <u>SNFPRM</u>, ¶ 105.

cost and achieving permanent access price reductions. It will also deter predatory pricing behavior because, by restricting the LEC's ability to raise a price after it has been lowered, it discourages temporary price reductions.

The two safeguards identified above are needed because, contrary to the Commission's suggestion, the current upper service band limit and the basket price cap do not provide adequate protections.[88] The basket PCI does not provide an effective check on LECs' ability to price a particular service below cost for a period of time, and then later raise it back to its previous level. The PCI only establishes a ceiling on aggregate prices of the LECs' services within a given basket. If a LEC sets its aggregate basket prices so they are below the basket PCI, it can raise them back to the PCI any time in the future on short notice. Pricing below the PCI creates permanent pricing "headroom" for the LEC, until it increases the aggregate basket prices back to its PCI.

The five percent upper SBI limit provides, at most, a limited check on a LEC's ability to increase the price of a service, after it has been decreased. In each LEC's annual filing, the upper and lower SBI limits are re-established in relation to the existing aggregate price levels within each band. Because (absent changes to the

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[88] SFNPRM, ¶ 83.

basket PCI) the upper SBI limits remain in effect for one year, and are then re-established in relation to the year-end aggregate band prices, a LEC can maneuver its prices to retain the same upward pricing flexibility that it had for the band before the price decrease.[89]

In short, the PCI and upper SBI limits provide only limited restrictions on LECs' ability to increase prices (and those restrictions are further subject to manipulation). Therefore, AT&T strongly urges the Commission to impose additional safeguards to limit the LECs' ability to increase prices after the lower SBI limits are eliminated. This is particularly important because the elimination of lower SBI limits will shift the burden of

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[89] See 47 C.F.R. § 61.47(e) (1994). For example, if the existing aggregate price of a service band at the time of a LEC's annual tariff filing is $100, the upper SBI limit will be established at $105. If the LEC decides to lower the aggregate band price down to its lower SBI limit of $90 at the beginning of the rate year, it can raise it back to its original level any time during the rate year. Additionally, if just prior to its next annual filing, the LEC increases the price back to $100, in the annual filing its new upper limit will again be established at $105, and the LEC will retain the same pricing flexibility that it had before. Only if the LEC continues to price the band at less than $100 into the next rate year would the new upper SBI limit be set at less than $105. Indeed, GTE and NYNEX both pursued the tactic of increasing rates just prior to their 1995 annual filings, to establish higher upper SBI limits. See GTE Telephone Operating Companies Transmittal No. 962, and GTE System Telephone Companies Transmittal No. 145, both filed May 8, 1995; NYNEX Transmittal No. 374, filed April 14, 1995.